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In the Supreme Court of the United States

OCTOBER TERM, 1942

No. 135

SECOND CAREY TRUST, AN EXPRESS TRUST, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 15–34) is reported at 41 B. T. A. 800. The opinion of the Court of Appeals (R. 95–101) is reported at 126 F. (2d) 526.

JURISDICTION

The judgment of the Court of Appeals was entered March 9, 1942. (R. 102.) Petition for a

writ of certiorari was filed June 9, 1942. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether the taxpayer trust during the year 1934 was an association within the meaning of Section 801 (a) (2) of the Revenue Act of 1934, taxable as a corporation.

2. If the taxpayer was taxable as a corporation, then whether the Board erred in denying taxpayer's motions, filed after the Board had promulgated its findings of fact and opinion upon the issues tried before it, (a) for further hearing so that taxpayer might introduce proof upon issues suggested by taxpayer's pleadings, and upon which the taxpayer might have but did not offer proof at the trial; and, (b) for leave to amend its pleadings to set up new issues not theretofore raised by the pleadings and for a hearing upon such new issues.

STATUTES AND REGULATIONS INVOLVED

These will be found in the Appendix, *infra*, pp. 19–31.

STATEMENT

The facts found by the Board (R. 16–26) may be summarized as follows:

The organization, powers, and operations of the taxpayer.—Taxpayer was organized as an "express

trust" under Oklahoma law by W. E. Brown, A. J. Diffie and H. I. Shanks on January 19, 1934 (R. 16, 74). By the trust instrument (R. 73–84) Brown, Diffie and Shanks undertook, as trustees, to hold, manage and operate as necessary for the unit holders in the trust an undivided one-eighth of the seven-eighths working interest in a certain lease known as the Westgate-Carey lease, covering 73 acres in Oklahoma County, Oklahoma, and four oil and mining leases in other counties in Oklahoma. Taxpayer paid its grantors approximately $400,000 for the property (R. 16).

Taxpayer obtained the funds with which to purchase its properties from the sale of nonassessable units of beneficial interest of the par value of $100 each. There were 5,000 authorized units, which were sold for a total consideration of $500,000, and a net amount of $400,000. Registration was obtained with the Securities and Exchange Commission (R. 17).

Each unit owner received a "Certificate of Interest in 'Second Carey Trust,' " upon which was shown the owner's name and the number of beneficial units he owned (R. 17, 85). The owner of each unit was entitled to receive a one five-thousandth part of the distributable net income and proceeds of the trust property (R. 17–18, 77, 85). The certificates were transferable only on the books of the trust and provided that the certificate owner

should have no authority to transact any business for the trust and no interest in the specific property of the trust, nor any right to demand a division of the property, and that the certificate owner should not be personally liable for any debts, covenants, contracts or torts of the trust or its trustees (R. 18).

The trust instrument (R. 73–84) authorized the trustees (and their successors) to operate and manage the trust and conduct all its business (R. 18–19, 21); to receive, collect and distribute the income (R. 21); to sell all or any part of the trust property with the consent of the owners of two-thirds in amount of the units in the trust (R. 21); to deduct from the gross receipts all expenses of managing and operating the trust, including as compensation for themselves five percent of the net receipts from whatever source derived (R. 22, 79); and then to distribute the balance of the net receipts, less a small amount withheld to meet current expenses, ratably among the unit holders monthly (R. 80). Until all units were sold, however, the trustees were to be entitled in their own separate right to so much of the net income of the trust as was in proportion to the number of unsold beneficial units (R. 19–20, 77).

The trust instrument further provided that neither the trustees nor the unit owners should be personally liable for the obligations of the trust (R. 24, 81–82); required the trustees to keep ac-

curate records and accounts (R. 82); and authorized them to fill any vacancies in the trusteeship (R. 83). The trustees were directed to conduct all business and execute all instruments under the name of the trust and to elect one of their number as president, one as vice president, and one as secretary-treasurer (R. 18–19, 76). The trust instrument also provided that the trust might be terminated at any time, upon written direction of the owners of two-thirds in amount of the beneficial units, but otherwise should continue for a period of 20 years and then be liquidated (R. 21, 78).

It was provided that ownership of units of beneficial interest by any person or persons should not create any partnership between the trustees and any such person or persons, nor between or among the unit holders; that the trustees should have no authority to create a partnership between themselves and any other person, firm or corporation with reference to the trust estate; that the trustees should at all times have the sole and exclusive right to manage the business of the trust; and that no unit holder should ever have the right as such to interfere with the trustees' management or control (R. 22–23).

It was also provided that the death, insolvency or bankruptcy of any unit holder or the transfer of his interest in any way during the continuance of the trust should not operate as a dissolution or termination of the trust, or have any effect whatever

on the trust estate (R. 23); and that the trust could be modified or amended by the trustees acting with the written consent of the holders of two-thirds in amount of the units (R. 24, 83).

On January 19, 1934, the Westgate-Carey lease was a producing lease and was being operated by the Westgate Oil Company. Additional wells were drilled on the property in 1934 (R. 16–17). As the owner of a working interest in the lease, the taxpayer became obligated to pay to the Westgate Oil Company its proportion of the expense of operating the oil wells on the lease and the cost of the new development. Taxpayer had a representative checking each bill as it came in (R. 17). The oil which was produced was sold on the premises to pipeline purchasing companies and taxpayer became entitled to its proportionate share of the proceeds (R. 17).

Taxpayer did not develop any of the four leases which it obtained along with the undivided one-eighth of the seven-eighths working interest in the Westgate-Carey lease, but allowed them to lapse.[1] (R. 16, 64).

Taxpayer has never purchased or acquired any other leases or lands than those described in the declaration of trust (R. 24). As the owner of its undivided one-eighth of the seven-eighths working

[1] The evidence is in conflict as to whether taxpayer paid rentals on the four leases (R. 64, 66).

interest in the Westgate-Carey lease it owns a like interest in the physical properties, including the operating equipment on the lease (R. 24).

There was some evidence before the Board (R. 33, 68) that, during 1934, the trustees permitted the trust to retain for distribution to the unit holders approximately $36,882.84 of income otherwise apportionable to unsold units of beneficial interest in accordance with the fifth paragraph of the trust instrument (R. 19–20, 77).

The trust did not set up on its books any capital or surplus accounts. Distributions to beneficiaries were made from the net receipts from the sale of oil and gas (R. 24, 67).

The returns filed, the issues before the Board, and the petitions for further hearing and to amend.— Taxpayer filed an income tax return for 1934 as a trust on form 1040, showing a net loss of $7,552.79. Among the deductions from gross income claimed were "Distributions to unit holders $55,986.00" and "depletion and depreciation $35,466.05." Taxpayer did not file with its return information data on form O in support of the claimed deduction for depletion and depreciation, as required by the Commissioner's regulations (R. 24–25).

Taxpayer did not file a capital stock tax return for the period ended June 30, 1934, nor has it made a declaration of the value of its capital for capital stock tax purposes. On October 1, 1937, a capital

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stock tax for that period, based on valuation of $500,000, and additional tax of 25 per cent was assessed, and taxpayer has paid such assessed taxes (R. 25–26).

In computing the deficiency in income and excess profits taxes for which he sent the taxpayer notice of deficiency (R. 9–12) the Commissioner held taxpayer to be an association taxable as a corporation, disallowed the claimed deduction of $55,986 as distributions to unit holders upon the ground that they constituted dividends, and also disallowed the deduction of $35,466.05 for depletion and depreciation for lack of evidence to substantiate the deduction (R. 12, 25).

Taxpayer filed a petition before the Board of Tax Appeals in which it alleged that it was not an association within the meaning of the Revenue Act, and in the alternative, if it should be held taxable as an association, that the computation of taxable net income made by the Commissioner was erroneous (1) for the reason that the computation was "based on accounts as recorded by a fiduciary in accounting for net cash receipts from whatever source derived, and which receipts do not constitute taxable net income," (2) because no allowance was made for depletion or depreciation, and (3) because no deduction was allowed, in the computation of excess profits tax, for 12½ percent of a declared value of capital (R. 4–5).

At the hearing before the Board taxpayer's counsel introduced evidence upon the issue whether or

not taxpayer was an association taxable as a corporation. No evidence was submitted from which either cost depletion or a deduction for depreciation could be computed. The Board held that the taxpayer was an association taxable as a corporation (R. 29); that, lacking evidence to show that taxpayer was entitled to depreciation or to depletion based on cost, it could allow taxpayer percentage depletion but not cost depletion and no depreciation (R. 30); and that taxpayer was entitled to a deduction of 12½ percent of an adjusted declared value of $500,000 for its capital stock in the computation of its excess profits tax (R. 33). The latter holding resulted in a determination that no excess profits tax was due from the taxpayer, the other holdings in a substantial reduction in the income tax which the Commissioner had proposed and determined (R. 39).

Some twenty-nine days after the Board promulgated its findings and opinion, taxpayer filed a "Motion for Rehearing, Re-Consideration, and Further Hearing" (R. 34–39), asking for reconsideration of the decision that taxpayer was an association and, in the alternative, if the Board should adhere to that portion of its decision, then for a rehearing so that taxpayer might present evidence upon the alternative issues raised by taxpayer's petition with respect to depletion, depreciation and valuation of taxpayer's capital stock for excess profits tax purposes, upon which taxpayer

had submitted practically no evidence at the trial. The Board denied this motion May 9, 1940 (R. 39). On July 19, 1940, the Board entered its decision pursuant to its findings of fact and opinion (R. 39).

On August 19, 1940, taxpayer filed another motion with the Board captioned "Motion to Vacate Board's Report and Decision; to Grant a New Trial or a Further Hearing; to Make Additional Findings; and to Allow Amendments to the Petition" (R. 40–49). In this motion taxpayer admitted that its case was tried "solely on the one ground that petitioner is not taxable as an association. No evidence was introduced to support the other assignments of error * * *" (R. 40). By its new motion taxpayer sought leave to renew its contention that it was not an association, leave to present evidence that it was entitled to a deduction for depreciation and to depletion based upon cost (rather than to percentage depletion) and the amount of the depreciation and depletion desired, and leave to amend its petition before the Board to ask for still further adjustments. The further adjustments desired were (1) the elimination from taxpayer's income of $36,882.84 in receipts from the sale of oil, which taxpayer asserted was capital contributed to it by the trustees as individuals, and (2) the deduction of $19,575.20 from income as development costs (R. 51–52). The Board denied this motion (R. 49).

The Court of Appeals affirmed the decision of the Board upon all issues.

ARGUMENT

A

The court below correctly ruled that the petitioner was taxable as an association rather than as a pure trust. The decision is in accordance with the decisions of this Court and there is no occasion for further review.

Petitioner's leading contention is that it is an "express trust" under Oklahoma law and that it therefore cannot be classified as an association taxable as a corporation under the Federal revenue acts. It may be conceded, *arguendo,* that petitioner is an "express trust" under Oklahoma statutes and decisions (see Sections 11820, 12369, Okla. Stats., Vol. 2, 1931; *State* v. *Prairie Cotton Oil Co.,* 180 Okla. 608); but this Court has squarely held that whether an organization is an association under the revenue acts does not depend upon its status under local law. *Burk-Waggoner Assn.* v. *Hopkins,* 269 U. S. 110. Compare *Morgan* v. *Commissioner,* 309 U. S. 78, 80–81; *Heiner* v. *Mellon,* 304 U. S. 271, 279; *Lyeth* v. *Hoey,* 305 U. S. 188, 193; *Burnet* v. *Harmel,* 287 U. S. 103, 110; *Weiss* v. *Wiener,* 279 U. S. 333, 337. The pertinent inquiry therefore is whether Congress intended the term "association," used in the federal statute, to include such an organization as the taxpayer.

The latter had all those features which ordinarily characterize such an organization: associates com-

bined in a business enterprise;[2] centralized management of the enterprise without termination or interruption by death of either a beneficial owner or a trustee or by changes in the ownership in interests; transferability of certificates; and limitation of the personal liability. It was, therefore, an "association" within the meaning of Section 801 (a) (2) of the Revenue Act of 1934, and taxable as a corporation. *Morrissey* v. *Commissioner*, 296 U. S. 344; *Helvering* v. *Combs*, 296 U. S. 365; *Swanson* v. *Commissioner*, 296 U. S. 362; *Helvering* v. *Coleman-Gilbert*, 296 U. S. 369; *Keating-Snyder Trust* v. *Commissioner*, 126 F. (2d) 860 (C. C. A. 5th); *Commissioner* v. *Fortney Oil Co., etc.*, 125 F. (2d) 995 (C. C. A. 6th); *United States* v. *Trust No. B. I. 35, etc.*, 107 F. (2d) 22 (C. C. A. 9th).

Taxpayer was not organized to liquidate property, but solely to provide a medium for the conduct of a business and sharing its gains. The purchasers of beneficial interest contributed their cash for that purpose. Their objective could be accomplished only by operation of the leases or leasehold interests or by the sale of the leases or interests therein. Either mode of realizing upon their interests in the leases contemplated activity of a business nature by the trustees. They and their

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[2] Lack of control over the trustees by the associates is not a decisive factor. *Morrissey* v. *Commissioner*, 296 U. S. 344, 355; *Helvering* v. *Combs*, 296 U. S. 365, 368; *Hecht* v. *Malley*, 265 U. S. 144. Moreover, the owners of two-thirds in amount of the units could repeal, modify or amend the trust (R. 83).

organization are "not at liberty [now] to say that their purpose was other or narrower than that which they formally set forth in the instrument under which their activities were conducted." *Helvering* v. *Coleman-Gilbert, supra,* p. 374. To like effect see *Keating-Snyder Trust* v. *Commissioner, supra; Kettleman Hills R. S. No. 1* v. *Commissioner,* 116 F. (2d) 382 (C. C. A. 9th), certiorari denied, 313 U. S. 582; *Sears* v. *Hassett,* 111 F. (2d) 961 (C. C. A. 1st). Taxpayer's assertion (Pet. 8) that the trustees had no power to develop the four leases disregards the terms of the trust instrument. (See R. 74, 76, 78, 82.) The fact that at the time of the creation of the trust the trustees did not know who would become beneficiaries is without significance. Those who purchased became none the less associates in the enterprise.

There is no conflict with *United States* v. *Cambridge Loan & Bldg. Co.,* 278 U. S. 55. The question there was one of statutory interpretation of the term "domestic building and loan associations" used in the Revenue Acts of 1918 and 1921. The Court held the term used in the sense in which the Treasury Regulations originally interpreted it, as meaning organizations which were building and loan associations under state law. The term "association" appearing in the federal act is, on the other hand, a term used in its ordinary sense as an organization analogous to and resembling but distinguished from a corporation. *Morrissey* v. *Commissioner, supra.* And the decision of this Court

in the *Burk-Waggoner* case, *supra,* establishes the result that state law is not determinative here.

Nor is the decision below in conflict with *Higgins* v. *Commissioner,* 312 U. S. 212, or *City Bank Farmers Trust Co.* v. *Helvering,* 313 U. S. 121. Both those cases arose under altogether different sections of the Revenue Acts; neither raised or involved the question whether the particular taxpayer was an "association." Nor is there conflict with *Cleveland Trust Co.* v. *Commissioner,* 115 F. (2d) 481 (C. C. A. 6th), certiorari denied, 312 U. S. 704, which is distinguishable upon its facts. Moreover, later decisions of the same court have held that oil trusts quite similar to the trust here involved are associations. See *Nashville Trust Co.* v. *Cotros,* 120 F. (2d) 157 (C. C. A. 6th), certiorari denied, 314 U. S. 680; *Commissioner* v. *Fortney Oil Co., supra.*

B

Taxpayer tried but one issue before the Board. As its counsel has admitted "no evidence was introduced to support the other assignments of error" (R. 40). In short, no evidence was introduced to prove the depreciation, if any, which taxpayer might have claimed, the depletion based on cost to which taxpayer might be entitled, if depletion based on cost of its deletable assets would exceed percentage depletion, or that in computing its excess profits tax the taxpayer was entitled to the use of any particular figure for the declared value of its stock. In the circumstances the Board of Tax Appeals

could do no more for the taxpayer on its alternative issues than to deny it a deduction for depreciation (R. 31), allow it percentage depletion (R. 31) and in addition a credit for excess profits tax purposes of 12½ per cent of $500,000 (R. 33). The taxpayer had sold its certificates of beneficial interest for $500,000 (R. 17) and in 1937, when the Commissioner assessed a capital stock tax against the taxpayer for the year ended June 30, 1934, that tax had been based on a capital stock valuation of $500,000 (R. 26). Thus the Board did the most it could for the taxpayer, on the record made at the trial.

Taxpayer's motions for further trial (R. 14, 34–39, 40–49) to prove the issues which it had not proved or attempted to prove at the trial,[3] and for leave to set up new and additional issues were, of course, addressed to the Board's discretion. *Bankers Pocahontas Coal Co.* v. *Burnet,* 287 U. S. 308, 312–313; *Skenandoa Rayon Corp.* v. *Commissioner,* 122 F. (2d) 268 (C. C. A. 2d). As the Board observed (R. 30), in denying taxpayer's first very general and noninformatory motion, "to grant the motion * * * would be tantamount to permitting the issues to be tried piecemeal after they were submitted as a whole. This we will not do." The denial of a rehearing and of further trial, in such circumstances, is not an abuse of discretion by the

[3] Indeed it is doubtful whether its allegations really raised those issues. See R. 4–5, 7.

Board. *Bankers Pocahontas Coal Co.* v. *Burnet, supra; Skenandoa Rayon Corp.* v. *Commissioner, supra; Holderness* v. *Commissioner,* 86 F. (2d) 137, 139 (C. C. A. 4th); *Commissioner* v. *Fortney Oil Co., supra; Steele-Wedeles Co.* v. *Commissioner,* 63 F. (2d) 541, 543 (C. C. A. 7th). See also *Rhodes* v. *Commissioner,* 111 F. (2d) 53, 57 (C. C. A. 4th); *Freeman-Hampton Oil Corp.* v. *Commissioner,* 65 F. (2d) 456, 457 (C. C. A. 5th); *O'Rear* v. *Commissioner,* 80 F. (2d) 473, 475–476 (C. C. A. 6th).

The taxpayer's final motion (R. 40–49) attempted to renew all the previous motions for rehearing and to set up new issues. Although an attempt to raise new issues was disavowed (R. 51), the proposed amendments to the petition, nevertheless alleged for the first time in this litigation (1) that $36,882.84 of the 1934 receipts "from the proportionate part of the trust property represented by unsold units" were not property of the taxpayer, but of its trustees, who contributed the $36,882.84 to taxpayer's capital in 1934, and (2) that taxpayer had $19,575.20 of development costs in 1934. Taxpayer alleged, in its proposed amendments, that the $36,882.84 was not income to it and that the $19,575.20 was a deductible expense (See R. 51–52). Taxpayer's attempt thus to inject new issues into the case was, of course, addressed to the discretion of the Board and was properly denied. *Bankers Pocahontas Coal Co.* v. *Burnet, supra,* p. 313, and other cases cited above. The Court of Appeals did not err in affirming the Board.

The court below denied taxpayer any relief with respect to the $36,882.84 item for the compelling reason that "the petitioner has raised no issue as to this in the pleadings" (R. 100). For purposes of further remarks the court then assumed that the $36,882.84 was a "gratuity" to the taxpayer from its trustees (R. 100).[4] Accordingly, there cannot be any conflict on this issue with *Rice, Barton & Fales* v. *Commissioner*, 41 F. (2d) 339 (C. C. A. 1st), and *American Dental Co.* v. *Commissioner*, (C. C. A. 7th), decided May 15, 1942, not yet officially reported but found in Prentice-Hall 1942, Vol. 4, par. 63,113, which in any event present different facts and issues.

Nor is the decision below in conflict with *Underwood* v. *Commissioner*, 56 F. (2d) 67 (C. C. A. 4th), or with *Ray W. Torrey Co.* v. *Commissioner*, 84 F. (2d) 659 (C. C. A. 6th). The trial in the *Underwood* case had proceeded upon an erroneous theory, which was shared by both parties, and in the course of the trial taxpayer proved his right to but did not prove the amount of the permissible

[4] We do not believe that the record justified the assumption. The $36,882.84 represented proceeds of the sale of oil and gas from the one-eighth of the seven-eighths working interest in the Westgate-Carey lease (R. 24, 67, 68). As such it constituted a part of the gross income of the taxpayer, the owner of the interest. Cf. *Helvering* v. *Horst*, 311 U. S. 112; *Anderson* v. *Helvering*, 310 U. S. 404, 408; *T. K. Harris Co.* v. *Commissioner*, 112 F. (2d) 76 (C. C. A. 6th); *Chicago, R. I. & P. Ry. Co.* v. *Commissioner*, 47 F. (2d) 990 (C. C. A. 7th), certiorari denied, 284 U. S. 618.

deduction. In the case at bar Government counsel objected from the outset to a split hearing (R. 61). In the *Torrey* case the taxpayer had alleged that it was entitled to file its returns on the installment basis and had proved its right to deductions on that basis but not the amount of the proper deductions. In addition the Board had lost some of the documentary evidence submitted at the trial. The Circuit Court of Appeals, in the particular situations, reversed and remanded the cases for further hearing. No such situation exists here. More nearly in point are the later decisions of the same courts in *Holderness* v. *Commissioner, supra,* p. 139; *Rhodes* v. *Commissioner, supra,* p. 57; *O'Rear* v. *Commissioner, supra,* pp. 475–476; *Commissioner* v. *Fortney Oil Co., supra,* next to last paragraph.

CONCLUSION

The decision below is in accord with applicable decisions of this Court. The Court of Appeals did not err in refusing to order a rehearing and further trial before the Board of Tax Appeals. There is no conflict of decisions. It is respectfully submitted that the petition should be denied.

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JUNE 1942.